



# PUTTING YOUR *Paycheck* TO WORK

FEDERAL RESERVE BANK OF KANSAS CITY

**FACT SHEET 2**

## MANAGING YOUR PAYCHECK - *WITHHOLDINGS*

*You've worked long hours and know your hourly wage—why then does your paycheck seem to be less than it should be? Your employer makes many deductions from your gross pay, which results in the amount you have to spend at the end of the pay period. Your employer is required to withhold money for taxes, Social Security and Medicare. Your employer may deduct other expenses, with your consent, for items like medical insurance, savings programs and parking costs.*

*It pays to understand how each of these items affects your paycheck and how you can manage them to best meet your needs.*

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### WHAT ARE WITHHOLDINGS?

Your employer is required by law to withhold money from your earnings to make certain payments for you.

### THESE REQUIRED PAYMENTS INCLUDE:

- Federal income taxes
- Social Security taxes
- Medicare taxes
- State and local taxes, if you live or work in an area that requires it
- Wage garnishments ordered by a court for payment of child support, debts or delinquent taxes

### HOW WITHHOLDINGS AFFECT YOUR PAYCHECK

#### *Federal Income Taxes and the W-4*

In general, you are required to pay taxes on your earnings as you receive them. This is the reason your employer is required to withhold some of your earnings each pay period to send to the Internal Revenue Service, or IRS. You can, however, manage how much is withheld each pay period.



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**PAGE 1**

## MANAGING YOUR PAYCHECK - WITHHOLDINGS

Your withholdings for taxes are determined by two pieces of information—how much money you make in a pay period and the information you provide on the Employee’s Withholding Certificate, or W-4 form. Your employer uses this information to determine how much money to withhold using tables provided by the IRS.

The W-4 is an important form completed by every employee. Too often, employees fill it out when they start a new job and then forget about it. You can change it at any time—and each change can impact how much your employer withholds, how much money is left in your paycheck, and whether at the end of the year you will get a tax refund or pay additional taxes.

### HOW DOES THE W-4 AFFECT YOUR TAX WITHHOLDINGS?

What does the W-4 do? The form provides five steps that allow your employer to calculate how much money to take out of your pay for taxes. These steps include:

- Enter personal information.
- Report multiple jobs or if a spouse works.
- Claim dependents.
- Make other adjustments to income and deductions.
- Sign the form.

A worksheet is provided with the W-4 to determine your allowances. The IRS also has an online calculator at [www.irs.gov](http://www.irs.gov) (or search “IRS W-4 calculator”) to help calculate your allowances.

### TRADE-OFFS BETWEEN NET PAY AND TAX WITHHOLDINGS

The information you provide on the W-4 affects the amount of money your employer will take out of your paycheck each pay period. By reducing the amount deducted, your employer will withhold less money from each paycheck. This will give you more money each pay period for living expenses.

So, should you withhold as little as possible in order to get more cash in your paycheck? If you do, you may enjoy the extra cash now but risk having to pay additional taxes at the end of the year. Why not withhold more if you can get by with less cash during the year, in order to enjoy a large refund later? While this can be a strategy to force yourself to save for big purchases, it can be costly if you find yourself using credit during the year for daily purchases.

Withholding Amount	Net pay amount each pay period	Likelihood of final tax payment or refund
The less money withheld	The greater your net pay	The more likely you are to pay additional taxes at the end of the year
The more money withheld	The less your net pay	The more likely you are to receive a refund at the end of the year

### REVIEW YOUR W-4

You should review your W-4 when you have any major changes in your life, such as a birth or death in the family, an adoption, a marriage or divorce. Other situations could include income changes because of a raise or your spouse starts a new job or is laid off. You should also review your W-4 if you have a large tax refund or large tax balance due at the end of the year. While you must decide what is best for your situation, you can manage your paycheck more effectively by understanding and using the W-4.

### SOCIAL SECURITY AND MEDICARE TAXES

Your employer is required to withhold some of your earnings each pay period for payment to Social Security and Medicare. These are two federal programs that provide several different benefits to workers and their families, such as monthly support for people that are retired and health benefits for workers that are disabled or over 65 years of age. *These withholdings are commonly referred to as FICA, or the Federal Insurance Contribution Act tax.*

Your withholding amount for these programs is established by law. The current rate for Social Security is 6.2% of your earnings, with an additional 1.45% of your pay going to Medicare. This amount is matched by a contribution from your employer.

The Social Security Administration has an online calculator to estimate the benefits you may receive from your social security contributions. The calculator is at [www.ssa.gov/estimator](http://www.ssa.gov/estimator).

### STATE AND LOCAL TAXES

Your employer may be required to withhold payments for state and local taxes in addition to federal taxes. Many, but not all, states have a personal income tax and other taxes that are collected through payroll withholdings. Some cities and other local taxing authorities may also require payments through withholdings. You should check with your employer about these requirements in your local area.

### WAGE GARNISHMENTS

A wage garnishment is when an employer is required to deduct money from your earnings to pay for a debt. Wage garnishments are often ordered by a court to pay for debts such as child support, federal or state taxes, bankruptcy or for other personal debts.

*Title III of the Consumer Credit Protection Act regulates wage garnishments, including limits on amounts that can be withheld and discrimination against employees that have a garnishment. This federal law is administered by the Wage and Hour Division of the U.S. Department of Labor. For additional information, search online for the Division's publication, Fact Sheet #30: The Federal Wage Garnishment Law, Consumer Credit Protection Act's Title 3 (CCPA).*

*“You may be surprised to find that deductions for retirement savings and other programs may have less of an impact on your net pay than you would think.”*

### ACTIONS TO GET MORE FROM YOUR PAYCHECK

- 1. Use an online W-4 calculator** to see the impact of your withholdings on your net pay. You can use the one available from the IRS at [www.irs.gov](http://www.irs.gov), or search for “W-4 calculator” to find other options.
- 2. Review your W-4 after major life changes**, such as marriage, divorce, birth of a child, or adoption.
- 3. Inform your employer if your address changes.** Your employer may send you important tax forms by mail that could be delayed or lost if your address is incorrect. Your change of address may also affect the state and local tax withholdings you are required to make.

### VISIT [HTTP://PAYCHECK.KCFED.ORG](http://PAYCHECK.KCFED.ORG)

for additional information and resources about understanding and managing your paycheck. This publication presents general information of interest to the public. It is not intended to provide specific advice or recommendations. *Fact sheets in the series “Putting Your Paycheck to Work” include:*

- *Understanding Your Paycheck*
- *Managing Your Paycheck – Withholdings*
- *Managing Your Paycheck – Deductions*
- *Getting Your Paycheck: Direct Deposit, Check or Payroll Card*
- *Expanding Your Paycheck: Benefits and Services to Consider*
- *Ten Actions to Get More from Your Paycheck*

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